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CITATIONS

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In the Supreme Court of the United States

October Term, 1948

No. —

Commissioner of Internal Revenue, petitioner

v.

L. B. Hartz

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

The Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Court of Appeals for the Eighth Circuit, reversing the judgment of the Tax Court.

OPINIONS BELOW

The memorandum opinion of the Tax Court (R. 230–251) is not reported. The opinion of the Court of Appeals (R. 272–279) is reported in 170 F. 2d 313.

JURISDICTION

The judgment of the Court of Appeals was entered October 27, 1948. (R. 280). The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTION PRESENTED

Whether the court below departed from *Commissioner* v. *Tower,* 327 U. S. 280, and *Lusthaus* v. *Commissioner,* 327 U. S. 293, in reversing the Tax Court's decision that income derived from capital and services contributed by taxpayer to a family partnership, part of which income was ascribed by the partnership agreement to other members of the partnership, was includible in taxpayer's gross income as defined in Section 22 (a) of the Internal Revenue Code.

STATUTE AND REGULATIONS INVOLVED

These appear in the Appendix, *infra,* pp. 15–16.

STATEMENT

The material facts as found by the Tax Court (R. 230–251) may be summarized as follows:

Prior to the taxable year (1941) taxpayer carried on as sole proprietor a wholesale and retail food distribution business, and reported the entire business income in his federal income tax returns. During the early years in which the business was expanding he borrowed various amounts from his sister, father, and mother, under an oral agreement to pay 6% interest, and used these amounts in his business. (R. 231–233, 245, 247.)

In 1941 taxpayer, his wife, sister, father, and mother executed a partnership agreement, dated as of January 2, 1941, the pertinent portions of

which are reproduced in the Tax Court's findings. (R. 233–236.) The agreement provided for division of the business assets then owned by taxpayer, and of the profits and losses of the business, in the following percentages: 25% each to taxpayer and his sister, 15% each to taxpayer's father and mother, and 20% to his wife. Taxpayer was to devote his full time to the business and, if agreed upon by all the partners, was to receive a salary. The other partners were to devote such time to the business as might be necessary. The partnership assumed the obligations of the business theretofore conducted by taxpayer as sole proprietor. (R. 234–235.)

The sister's 25% interest in the business was derived from two instruments, an assignment and a bill of sale from taxpayer, each bearing the same date as the partnership agreement. Under the assignment she received a 10% interest having a recited value of $15,253. Under the bill of sale she received a 15% interest in consideration of $22,879, payable $6,500 down and the balance at the rate of $1,500 per year (with 3% interest) commencing July 1, 1942. The $6,500 payable at the date of the bill of sale corresponded with the total amount which she had previously loaned to taxpayer for investment in the business at 6% interest. At the time of the Tax Court hearing she had paid under the bill of sale an additional $9,000, which amount represented about one-half

of the share of the 1941 profits ascribed to her under the partnership agreement. (R. 236–237, 249.)

The father's 15% interest was likewise derived from an assignment and a bill of sale from taxpayer, each bearing the date of the partnership agreement. Under the assignment he received a 13% interest having a recited value of $19,828. Under the bill of sale he received a 2% interest in consideration of $3,050, of which $1,300 was acknowledged as paid and the balance was to be paid within one year. The $1,300 acknowledged as paid under the bill of sale corresponded with the total amount he had previously loaned to taxpayer for investment in the business at 6% interest. In 1941 he paid $300 and in 1942 he paid $1,000 under the bill of sale, and no attempt has been made to collect the unpaid balance. (R. 237, 248–249.)

The mother's 15% interest also was derived from an assignment and a bill of sale dated simultaneously with the partnership agreement. Under the assignment she received a 14.025% interest having a recited value of $21,735. Under the bill of sale she received a .075% interest in consideration of $1,143, of which $1,000 was acknowledged as paid and the balance was to be paid in one year. The $1,000 acknowledged as paid corresponded with the amount she had previously loaned to taxpayer for investment in the

business at 6% interest. The balance payable under the bill of sale was never paid, and no attempt was ever made to collect it. (R. 237-238, 248.)

The wife's 20% interest was acquired solely by an assignment from taxpayer (also dated simultaneously with the partnership agreement), which recited the value of her interest to be $30,506. She had given $400 to taxpayer in 1937, which was not to draw interest. (R. 238, 245.)

Taxpayer filed a gift tax return in 1942 in which he reported the above assignments as gifts, and paid the gift tax. (R. 238.)

Taxpayer's sister was 52 years old at the time of the Tax Court hearing, was a retired school teacher, and had a net worth in 1941 of about $23,000; she helped at home, and also did charity work. (R. 239.) Taxpayer's father was 79 years old, was a retired carpenter, and his net worth in 1941 was between $20,000 and $25,000; he occasionally supervised the installation of fixtures in new stores and assisted in sales of honey. (R. 239.) Taxpayer's mother was 74 years old and took no part in the conduct of the business. (R. 240.) Taxpayer's wife entertained business customers, accompanied taxpayer on visits to stores, at times assisted in opening new stores, made some suggestions about personnel and operations, did considerable testing of samples, occasionally took orders and relayed them to the

warehouse, and assisted in some of the clerical work. She never did any regular work or put in regular hours. (R. 240.) Her services after formation of the partnership were substantially the same as those she previously rendered. (R. 246.) All of the partners attended informal meetings, which were merely reports by taxpayer of past and intended operations. (R. 250.) None of the partners drew any salary (R. 240), and none of them other than taxpayer performed services sufficient to render them partners (R. 246, 250). The reasonable value of taxpayer's services to the business was $500 per month. (R. 251.)

The gross sales of the business rose from $608,-900 in 1935 to $2,298,563 in 1941. The net income rose from $7,695 in 1935 to $69,906 in 1941. The net worth of the business at the close of 1940, when the partnership was formed, was $152,530. (R. 240.) Taxpayer was the only partner who made any withdrawals during 1941. (R. 242.)

At the end of 1941 and during 1942 the business borrowed substantial amounts of working capital from a bank. Repayment of the loans was guaranteed by the partners under an instrument signed by them as individuals. (R. 241.)

A "Certificate of Business Name" was filed by the partnership in 1943. (R. 239.) In 1942 and 1943 two actions were instituted in the United

States District Court in Minnesota, one by the Wage and Hour Administration and the other by the Office of Price Administration, in which the business was sued as a partnership; in neither proceeding was the issue of a partnership for federal income tax purpose raised or adjudicated. (R. 241–244.)

In his income tax return for 1941 taxpayer reported 25% of the business net income for that year, and the Commssioner determined that all of it was taxable to him. (R. 8, 230.) The Tax Court, relying upon *Commissioner v. Tower,* 327 U. S. 280, and *Lusthaus* v. *Commissioner,* 327 U. S. 293, held that the income was taxable to the partners in proportion to their respective contributions of services and of capital originating with them. Accordingly it ruled that (1) a reasonable salary ($6,000) was allocable for the services of taxpayer, the only partner who furnished significant services; (2) the balance of the income was allocable to taxpayer, his sister, his mother, and his father in the ratios which their actual contributions of capital (i. e., exclusive of taxpayer's gifts to them by way of the assignments and bills of sale) bore to the net worth of the business at the formation of the partnership; and (3) none of the income was allocable to taxpayer's wife, whose only contribution consisted of capital donated to her by taxpayer. (R. 248–251). Upon the taxpayer's

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appeal, the Court of Appeals reversed, holding that the Tax Court was obliged to accord tax effect to the gifts and the terms of the contemporaneous partnership agreement. (R. 279.)

SPECIFICATION OF ERRORS TO BE URGED

The Court of Appeals erred:

(1) In holding, contrary to the principles enunciated by this Court in *Commissioner* v. *Tower*, 327 U. S. 280, and *Lusthaus* v. *Commissioner*, 327 U. S. 293, that a portion of the income of a family partnership derived from taxpayer's capital and services was taxable to the other partners.

(2) In holding, contrary to the *Tower* and *Lusthaus* decisions, that taxpayer's wife became his partner for tax purposes by virtue of his gift to her of a portion of his business capital.

(3) In reversing the judgment of the Tax Court.

REASONS FOR GRANTING THE WRIT

1. The reasons for requesting further review of this family partnership case are even more pressing than those stated in the Government's petition for certiorari in *Commissioner* v. *Culbertson*, No. 313, granted December 6, 1948, for the decision below marks a dual departure from the principles laid down in *Commissioner* v. *Tower*, 327 U. S. 280, and *Lusthaus* v. *Commissioner*, 327 U. S. 293. The court below not only reversed the Tax Court's refusal to accord part-

nership status for tax purposes to a member of taxpayer's family (his wife) who contributed neither capital of her own nor vital additional services to the business. It also rejected the Tax Court's determination that the partnership income was taxable to the remaining partners (taxpayer, his father, mother, and sister) in accordance with their respective contributions of capital and services, and held that the Tax Court was bound to accept the allocation agreed upon by the parties.

In the *Tower* and *Lusthaus* cases this Court held that a transfer by a husband to his wife of a portion of his business capital was ineffectual to render the wife his partner for federal income tax purposes, and that the husband remained taxable on the entire business income under Code Section 22 (a), Appendix, *infra.* The rationale of the decisions is that business income derived from a blend of capital and services is taxable to him who earns it, and that claimed family partnerships are subject to special scrutiny lest what is in reality the taxable income of one member of the family be deflected to another. The "basic question" is who "earned" the business income; unless the transferee-partner "invests capital originating with her or substantially contributes to the control and management of the business, or otherwise performs vital additional services, or does all of these things" (*Commis-*

sioner v. *Tower,* pp. 283, 289, 290), the Tax Court is fully justified in concluding that all the business income is earned by, and hence taxable to, the transferor-partner. See also *Commissioner* v. *Sunnen,* 333 U. S. 591, 606.

Since the *Tower* and *Lusthaus* decisions were handed down the Tax Court has been confronted with family partnerships whose members are entitled to some recognition as partners, but who have reported the total business income in shares palpably disproportionate to their respective contributions of capital and services.[1] In harmony with the *Tower* and *Lusthaus* principles, the Tax Court in such cases has held that income earned by one of the partners may not be ascribed by agreement to the others, and it has endeavored to give practical effect to those principles by reallocating the business income in accordance with the partners' respective contributions of capital and services.[2] In so doing the Tax Court has recognized, of course, that mathematical certitude is an impossibility; it has attempted, on the basis of the facts of each case, to supplant an allocation which bears no reasonable relationship to the respective contributions of the partners with one

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[1] As in this case, the arrangement has usually taken the form of a transfer of a portion of the taxpayer's capital to a member of his family, superimposed upon a contribution of some capital originating with the transferee.

[2] This approach has also been accepted by the Treasury in such cases. See "Bureau Policy with Respect to So-called Family Partnerships," I. T. 3845, 1947-1 Cum. Bull. 66.

which does. But in each instance in which the taxpayer has appealed, including the present case, the Tax Court's decision has been reversed.[3]

If the Tax Court is obliged to accord tax effect to a division of family partnership income which is patently disproportionate to the shares actually earned by the partners, merely because the parties have agreed upon such a division, the *Tower* and *Lusthaus* decisions will for all practical purposes be stripped of substantial force. A deflection of a portion of the income of a family partnership from one partner to another is no more tolerable under the doctrine of those cases than the deflection of a portion of the income of a sole proprietorship to a claimed partner; the difference is one of degree, not of kind. That members of the taxpayer's family are entitled to recognition as his business partners by virtue of a contribution of *some capital* ought not foreclose an inquiry by the taxing authority into whether the shares of the total business income reported by the partners bear a reasonble relationship to their respective contributions of capital and services. To hold otherwise would reopen a door to income tax splitting within the family group which, we believe, the *Tower* and *Lusthaus* decisions meant effectively to close. And the *Tower* and *Lusthaus*

[3] *Canfield* v. *Commissioner*, 168 F. 2d 907 (C. A. 6); *Woosley* v. *Commissioner*, 168 F. 2d 330 (C. A. 6); *Walsh* v. *Commissioner*, 170 F. 2d 535 (C. A. 8).

decisions could always be circumvented by having the new partners contribute a comparatively trivial amount of new capital in exchange for a substantial interest in the enterprise.

2. The facts found by the Tax Court unquestionably warrant its conclusion that portions of the business income reported by members of taxpayer's family as his partners were derived from taxpayer's capital and services, and hence taxable to him. Prior to 1941 (the taxable year) the business had been conducted by taxpayer as sole proprietor, and he reported the total income. (R. 231–233, 245, 247.) As of the beginning of 1941 he entered into a partnership agreement with his wife, sister, father, and mother, whereby they agreed to own the assets and share profits and losses in specified percentages (R. 233–235); and contemporaneously with the formation of the partnership he made gifts and purported sales of portions of his business capital to the newly admitted partners (R. 236–238). The net worth of the business at the time was $152,530. (R. 240.) Under the arrangement the wife received a 20% interest ($30,506), predicated entirely on taxpayer's gift to her of a corresponding percentage of the business assets. (R. 238, 245.) The sister received a 25% interest, of which 10% ($15,253) was by way of gift and 15% ($22,879) by way of sale from taxpayer, whereas the capital actually contributed by her totaled $6,500. (R. 236–237, 249.) The father received a 15%

interest, of which 13% ($19,828) was by gift and 2% ($3,050) by sale from taxpayer, whereas the capital actually contributed by him totaled $1,300. (R. 237, 248–249.) The mother received a 15% interest, of which 14.025% ($21,735) was by gift and 0.075 ($1,143) by sale from taxpayer, whereas the capital actually contributed by her totaled $1,000. (R. 237–238, 248.) The only partner who contributed vital services to the business was taxpayer, and he drew no salary. (R. 239–240, 246, 250.) Applying the *Tower* and *Lusthaus* principles, the Tax Court held that the 1941 business income was taxable to the partners in proportion to their respective contributions of services and of capital originating with them. Accordingly, it allocated a reasonable amount to taxpayer for his services, and directed that the balance of the partnership income be allocated to taxpayer, his sister, father, and mother in ratios which their actual contributions of capital bore to the total capital invested in the business. As for the wife, who contributed neither capital of her own nor vital additional services, it held that none of the income was attributable to her. (R. 250–251.)

Although the court below professed to accept the facts as found by the Tax Court, it reversed on the theory that "a valid partnership" had been created and that consequently "the Tax Court had no right to re-apportion the income of the partnership between the partners for tax pur-

poses." (R. 179.)[4] Its holding with respect to taxpayer's wife—who contributed neither vital additional services nor capital of her own—is squarely contrary to this Court's decisions in the *Tower* and *Lusthaus* cases. And its holding with respect to the mother, father, and sister—who contributed some capital of their own, but were ascribed shares of the profits based on capital transferred to them by taxpayer—is repugnant to the principles underlying those decisions. In effect, the decision below renders any division of family partnership income selected by the parties binding upon the Government, and the partners themselves the sole judges of the proportions in which the total income is taxable to them. If permitted to stand it will sanction the shifting of tax liability from one member of a family partnership to another by mere agreement of the parties, and cause serious loss of revenue.

CONCLUSION

The petition for a writ of certiorari should be granted.

PHILIP B. PERLMAN,
Solicitor General.

JANUARY 1949.

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[4] The court disposed of the allocation problem, to which the Tax Court had chiefly addressed itself, with the observation that an "artificial" division of family partnership income would warrant a complete disregard of the partnership. (R. 279.) The question here (except as to the wife) is not the artificiality of the partnership, but of the allocation of the partnership income.

APPENDIX

Internal Revenue Code:

SEC. 11. NORMAL TAX ON INDIVIDUALS.

There shall be levied, collected, and paid for each taxable year upon the net income of every individual a * * * tax * * *.
(26 U. S. C. 11.)

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * *, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *
(26 U. S. C. 22.)

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.
(26 U. S. C. 181.)

SEC. 182. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

* * * * *

(c) His distributive share of the ordinary net income or the ordinary net loss of

the partnership, computed as provided in section 183 (b).

(26 U. S. C. 182.)

SEC. 3797. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

* * * * *

(2) *Partnership and Partner.*—The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

* * * * *

(26 U. S. C. 3797.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.22 (a)-1. *What included in gross income.*—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (See sections 22 (b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, * * *.

U. S. GOVERNMENT PRINTING OFFICE: 1949

IN THE

Supreme Court of the United States

October Term, 1948

No. 520

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

L. B. HARTZ.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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No. 520

COMMISSIONER OF INTERNAL REVENUE,
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L. B. HARTZ.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinion of the Tax Court, only considered and rendered by the one judge who heard the case

(R. 230-251), is not reported. The unanimous opinion (three judges sitting) of the Court of Appeals (R. 272-279) is reported in 170 F. 2d 313.

JURISDICTION

The judgment of the Court of Appeals was entered October 27, 1948 (R. 280). The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTION PRESENTED

Did the court below correctly decide that the Tax Court erred in not holding that the parties really and truly intended to create a bona fide partnership as agree upon, because it failed to give due deference to the uncontroverted evidence that the partnership was created in good faith for the purpose of obtaining necessary working capital to insure the continued existence of the business and because it failed to recognize all of the contributions of capital, credit, services, management, and direction each partner made to the partnership?

STATUTES AND REGULATIONS INVOLVED

These are set forth in the Appendix, infra, pp. 13-15.

STATEMENT

The summarization of the facts by the petitioner is grossly misleading and in many instances incorrect. The following statement is therefore supplementary to the statement of the petitioner and corrective of errors contained therein:

The petitioner ignores the fact that the father, mother, sister, and taxpayer were all members of an admittedly bona fide and valid family partnership during the years from 1911 to 1917. This partnership conducted a truck farming business, which involved merchandising as well as growing, and gave those members of the partnership a background fitting them for the larger wholesale and retail food distribution business (R. 230, 272). It was really the origin of the business in question.

Petitioner states that prior to the taxable year taxpayer carried on the business in question as a sole proprietor. This is incorrect. From 1928 to the middle of 1937 the business was incorporated and conducted by the corporation. The incorporators were the taxpayer, his father, and sister. All of the members of the original family partnership were shareholders in the said corporation (R. 231, 232, 273, 274). The corporation was created for the purpose of obtaining "outside" capital, failed in its purpose, and was abandoned by its shareholders (R. 232, 273).

Petitioner states that the taxpayer borrowed various amounts from his sister, father, and mother during the early years in which the business was "expanding". This is incorrect. All of the initial working capital of the business came from the father and sister (R. 231, 273). Each cash investment of each partner was made at a critical time in the life of the business when there was either a serious

financial emergency or the business was decreasing, not "expanding". For example, in 1938 the father invested $1,000.00 at a time when the business was involved in a serious lawsuit and the funds of the business in several of the banks were garnished (R. 49, 50, 113, 114, 273, 237, 238). The wife contributed $400.00 at a time when checks were "bouncing" (R. 100, 157). The undisputed testimony of the taxpayer, his father, and sister was that they and the mother were to have an interest in the business by reason of their investments, and 6% interest (R. 273).

Total cash contributions to the capital of the business originating from sources outside the business as of the time of the hearing were as follows:

Taxpayer	$ 2,500.00	
Miss Louise K. Hartz	15,500.00	
Bernard J. Hartz	2,600.00	
Mrs. Louise K. Hartz	1,000.00	
Harriet L. Hartz	400.00	(R. 273, 274)

In addition to provisions of the partnership agreement referred to by petitioner, the agreement provided that each partner was to have free access to all books and accounts of the partnership, and each partner agreed to enter in the books all receipts, withdrawals, and other financial transactions involving any money or other property of the partnership, together with explanatory particulars with reference thereto. Authority to sign checks, notes, or other negotiable papers vested in taxpayer or any two of the other partners (R. 234, 235). Sharing of losses was in the same percentages as sharing of profits. The substantial independent means of the other partners were subjected to this liability (R. 239). The taxpayer had no means outside of his interest in the business.

The forms used to get the legal title into the names of the respective partners were employed to eliminate any question with the government of possible gift taxes. Gift taxes were paid to eliminate argument, although the parties did not consider the assignments as gifts (R. 67, 276), but a fulfillment of the understanding the parties had when investments were made (R. 67, 147).

In 1941 the taxpayer withdrew from the business a total of $2,995.06. From 1941 to and including 1945 all of the partners made comparatively small withdrawals from the business (R. 242).

Petitioner states that shortly after the formation of the partnership, the business was sued as a partnership in the United States District Court in Minnesota by two administrative agencies of the United States. This is incorrect. The business was not sued. The partners were sued. In one of these cases, a final judgment was entered, which is still in effect, restraining each of the partners—not the business. A partnership was found to exist in both cases (Exhibits 15 and 16).

The existence of the partnership was well known and widespread (R. 242, 276).

All of the partners participated in the direction and management of the business by giving advice and making suggestions as to the operations of the business at frequent and regular conferences (R. 69, 70, 189, 208, 215, 277). These meetings were not just report meetings as asserted by petitioner.

Petitioner's statement to the contrary notwithstanding, taxpayer's wife rendered vital services to the business "which were concededly greater than those ordinarily rendered by a wife in her husband's business" (R. 192, 279), and were ex-

actly the same type of work the taxpayer rendered in the same store at the same time (R. 143, 274). Among many other duties, the wife conducted the sample-testing for the business. The company guaranteed all of its products, and this testing was important and vital (R. 143, 144).

Petitioner admits that the business borrowed substantial amounts of working capital from a bank during 1941 and 1942. Petitioner neglects to mention that without this loan the entire business would have collapsed, and that without the formation of the partnership, the loan would never have been made (R. 251, 276, 277).

During 1940, and prior thereto, the business borrowed working capital from six different banks in the area. During 1940 these banks called their loans (R. 54, 55, 56). After the formation of the partnership, the business obtained bank credit up to $155,000.00 (R. 202, 205). The bank loaned this money by reason of the formation of the partnership because: (1) it did not like a "one-man business" and recognized the necessity of having "partners who can carry on the business," (R. 199) and (2) the partners, other than the taxpayer, had substantial independent means which were exposed to the liabilities of the business. The bank insisted the partners personally guarantee the loan to facilitate collection if necessary (R. 203, 239).

The Tax Court did not find that the partnership was created in bad faith or for the purpose of avoiding taxes. On the contrary, it found that the partnership was created for a real business reason, i. e., to raise immediately needed capital (R. 251).

The Court of Appeals did not hold that the Tax Court was obliged to accord tax effect to the gifts and the terms of the contemporaneous partnership agreement. The Court

of Appeals pointed out that the Tax Court had failed "to find and give due deference to the uncontroverted evidence that this partnership was created in good faith for the purpose of obtaining necessary working capital to insure the continued existence of the business," and that there was ample justification for the assignments which were made by the taxpayer to the partners. The assignments were not gifts. The Court concluded that "This record compels the conclusion that this was a valid partnership" (R. 279). But the Court of Appeals said, "In so holding, we do not mean to say that a division of income between alleged partners must necessarily be adhered to for tax purposes merely because it is written into an alleged partnership agreement."

REASONS FOR DENYING THE WRIT

1. The Decision of the Court of Appeals is Correct and not Contrary to any Decision of this Court.

This is not the case of *Commissioner vs. Culbertson*, No. 313, or anything like it. In that case, petitioner asserted "that taxpayer's four sons contributed no capital of their own, nor any vital additional services (managerial or otherwise) to the business, and hence did not become his partners for tax purposes." (See Petition for Writ, No. 313, p. 10.) In this Hartz case, each partner did contribute capital to the business which originated from sources outside of the business. In fact, the sister and father contributed a greater amount of such capital than did the taxpayer. But for such contributions, the business would never have come into existence, nor would it have survived. Each of the partners actually took part in the direction and management of the busi-

ness. There were regular family conferences held, at which times all of the partners reviewed the past and took part in making plans for the future. It cannot be doubted that much of the success of this business depended upon the perspective given it by the partners. The taxpayer's wife rendered vital additional services to the business—services which were the same as those rendered by the taxpayer, and which were concededly greater than those ordinarily rendered by a wife in her husband's business.

Apparently the petitioner has completely misunderstood the decision of the Court of Appeals. The court below did not hold that members of a taxpayer's family were entitled to recognition as business partners merely by virtue of a contribution of some capital to the business, and that the taxing authority was thereby foreclosed from inquiry into the relationship between the contribution and the allocation of the business income agreed upon by the partners. Nor did the court below hold that the wife became a partner for tax purposes by virtue of a gift to her. The Court of Appeals held quite to the contrary and followed *Commissioner vs. Tower*, 327 U. S. 280, and *Lusthaus vs. Commissioner*, 237 U. S. 293.

The court expressly stated that the taxing authority is not bound by any artificial or unwarranted division of income which might be agreed upon by the partners. It was recognized and stated that a taxpayer could not avoid taxes by creating an artificial partnership, nor could he deflect a portion of his earned income from one partner to another upon any unreasonable basis.

The Court of Appeals accorded the high respect to which the Tax Court's findings were entitled.[1] It did not hold that

[1]Section 36 of Public Law 773, approved June 25, 1948, and effective September 1, 1948, amending Section 1141(a) I. R. C.

the facts found by such court were not supported by the evidence. The Tax Court had overlooked some undisputed facts and had reached obviously incorrect conclusions of law from the facts it had found.

The Tax Court erred when it neglected to give each of the partners due credit for the following uncontroverted facts:

1. That they risked their capital in a new and risky business, at times when strangers were unwilling to invest capital in the business.[2]

2. That they risked all of their substantial independent means in order to enable the business to obtain credit at a time when outsiders, bankers, who knew the business, were calling all their loans.

3. That they became "partners who (could) carry on the business" when and if necessary in order to enable the business to get substantial and necessary bank credit.

4. That in the business world, a large Minneapolis bank thought the partnership was real enough to extend credit up to $155,000.00.

5. That they did render services to the business, which services were of value to the business.

6. That they did contribute valuable ideas and suggestions for the operation of the business, and participated in its management and control.

7. That they contributed a valuable perspective to the business, which the taxpayer, so close to the business, could not have had.

[2]The value of money to a business is relative, depending on its need and its availability. In the beginning, money could not be had at any price. Only the relatives who had faith were willing to put money into the business. Even after the business was established and incorporated, it was impossible to sell stock and raise necessary outside capital. The value of early risk capital is well known. *Jay A. Mount*, 5 T. C. M. 1004, P-H Memo T.C. ¶ 46, 276; *Thomas F. Kelley*, 9 B. T. A. 834; *H. D. Webster*, 4 T. C. 1169; Estate of *Frank G. Ennis, Sr.*, 5 T. C. 1096; *Leo Marks*, 6 T. C. 659; *Weizer vs. Commissioner*, 165 F. 2nd 772; *Wilson vs. Commissioner*, 161 F. 2nd 661.

8. That at the time of the formation of the partnership, the partners agreed to and thereafter did contribute substantial additional capital which originated from outside sources.

2. The Issue of Reallocation is not Before this Court and was not Before the Lower Courts.

While the Court of Appeals obviously found that the division of profits between the partners was fair and reasonable, which finding accords with the evidence, the question of reallocation was never before either the Tax Court or the Court of Appeals.

The Commissioner assessed all of the income of the business to the taxpayer. In the taxpayer's petition to the Tax Court, he alleged there was a valid and bona fide partnership as set out in the partnership agreement (R. 3, 4, 5). The Commissioner, in his answer, maintained his initial position and denied there was any partnership (R. 9, 10, 11). In fact, he denied there was any contribution of anything to the partnership by any of the partners other than taxpayer. At no time during the trial or in his brief following the trial did the Commissioner suggest that the income of the business should be reallocated between the members of the partnership.

The question of whether the parties really and truly intended to create a partnership or, as to that issue, whether the allocation of income of the business as agreed upon by the parties was reasonable, is quite different from whether the income should be reallocated, and if so, on what basis. Had reallocation been a proper issue in the case, evidence of the contribution of each partner to the partnership would have

been much more detailed and elaborate. Specific evidence of the relative value of each respective contribution by each partner would have been submitted if possible.

It is elementary that no court will consider issues not raised by the pleadings.[3]

The "Bureau Policy",[4] to enable agents to settle family partnership cases on a basis other than that agreed upon by the partners, was issued subsequent to the trial of this case before the Tax Court.

3. No Important Issue is Presented by This Record.

Of all the many family partnership cases before the Tax Court (about 350), only five other cases have involved any consideration of reallocation.[5]

The facts and conclusions in this case are peculiar to this case and cannot be determinative of any other case.

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[3] *Reynolds v. Stockton*, 140 U. S. 254; *S. E. Boozer*, 6 T. C. M. 1021 *William F. Horsting*, 5 T. C. M. 421; *Wentworth Mfg. Co.*, 6 T. C. 1201; *Eric H. Heckett*, 8 T. C. 841; *Maurice P. O'Meara*, 8 T. C. 622. Rule 14 of the Rules of Practice of the Tax Court provides,—"Answer . . . The answer shall be so drawn as fully and completely to advise the petitioner and the Court of the nature of the defense." P-H. ¶21, 577.

[4] See "Bureau Policy with Respect to So-called Family Partnerships", IT 3845, 1947-1 Comm. Bull. 66.

[5] The first case of *Max German*, 2 T. C. 474, was not really a reallocation case because the court found there was no partnership between the husband and wife in the personal service business, no partnership agreement having been made during the taxable year, but did allocate 25% of the income to the wife and 75% to the husband. In the case of *William J. Hirsch*, 4 T. C. M. 4, the Commissioner sought reallocation but the Tax Court rejected the idea because of its "impracticability". In the cases of *Canfield v. Commissioner*, 168 F. 2d. 907, and *Woosley v. Commissioner*, 168 F. 2d 330, the Court of Appeals held the facts in neither case warranted reallocation. No review was sought in either of these two cases. The case of *David L. Jennings*, 10 T. C. 505, involved a personal service business, and the taxpayer agreed to a reallocation in the Tax Court. There are now no reported reallocation cases pending. See P-H ¶ 15, 508. The case of *Walsh v. Commissioner*, 170 F. 2d 525, cited by petitioner, does not involve any question of reallocation. No review will be sought in this case. P-H 71,040.

CONCLUSION

The petition for certiorari should be denied.

Respectfully submitted,

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APPENDIX

INTERNAL REVENUE CODE:

SEC. 11. NORMAL TAX ON INDIVIDUALS.

There shall be levied, collected, and paid for each taxable year upon the net income of every individual a * * * tax * * *.

(26 U.S.C. 11.)

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * *, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(26 U.S.C. 22.)

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

(26 U.S.C. 181.)

SEC. 182. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him —

* * * * * *

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183(b).
(26 U.S.C. 182.)

SEC. 3797. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof —

* * * * * *

(2) *Partnership and Partner.*—The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust, or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

* * * * * *

(26 U.S.C. 3797.)

SEC. 1141. COURTS OF REVIEW.

(a) Jurisdiction.—The circuit courts of appeals and the United States Court of Appeals for the District of Columbia shall have exclusive jurisdiction to review the decisions of the Tax Court, except as provided in section 1254 of title 28 of the United States Code, in the same manner and to the same extent as decisions of the district courts in Civil actions tried without a jury; and the judgment of any such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari, in the manner pro-

vided in section 1254 of title 28 of the United States Code.

* * * * *

(c) Powers.—

(1) To affirm, modify, or reverse.—Upon such review, such courts shall have power to affirm or, if the decision of the Board is not in accordance with law, to modify or to reverse the decision of the Board, with or without remanding the case for a rehearing, as justice may require.

(26 U.S.C. Sec. 1141(a)(c))

28 U.S.C. SEC. 875.

"875. *Review in cases tried without jury.*—When an issue of fact in any civil cause in a district court is tried and determined by the court without the intervention of a jury, according to section 773 of this title, the rulings of the court in the progress of the trial of the cause, if excepted to at the time, and duly presented by a bill of exceptions, may be reviewed upon appeal; and when the finding is special the review may extend to the determination of the sufficiency of the facts found to support the judgment."